



Cost of Service Ratemaking

Presentation to the House Energy & Technology Committee
February 18, 2014

Michigan Public Service Commission
Department of Licensing and Regulatory Affairs



MICHIGAN PUBLIC SERVICE COMMISSION

Rate Case Process

- Request for rate increase initiated by utility
- Provides MPSC Staff, other interveners (Attorney General, ABATE, MCAAAA, MEC, etc.) ability to scrutinize requests through contested case proceeding
- MPSC determines final rates

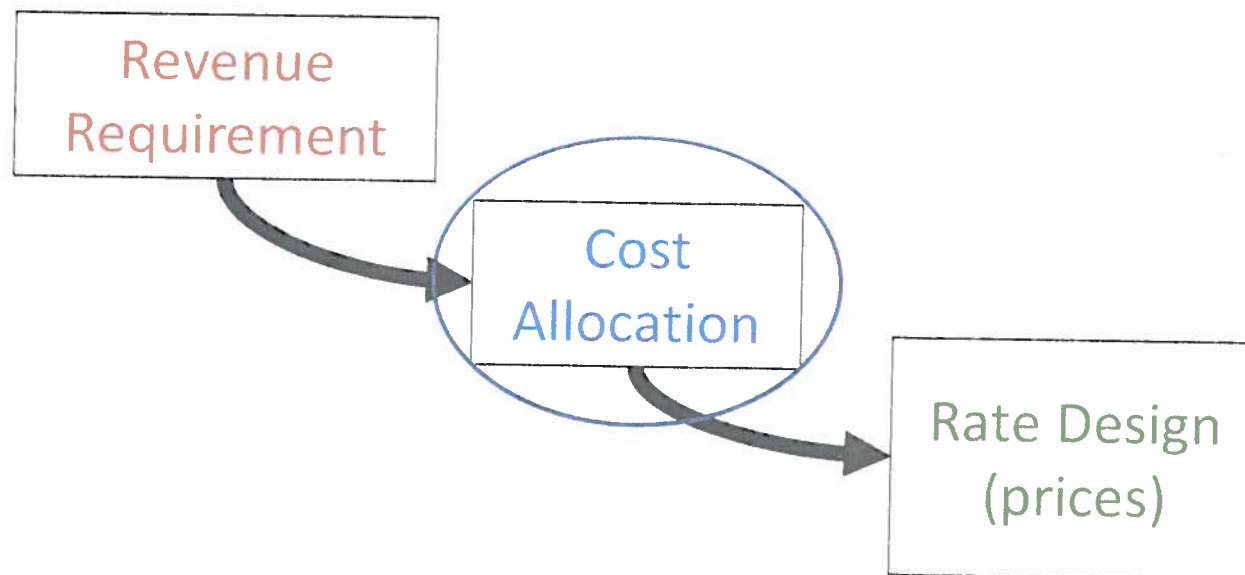


Rate Development

- Determination of **Revenue Requirement** (cost assessment) for a test year
- **Allocation of Costs** to customer classes based on usage patterns
 - Cost of service study
- **Rate Design** to recover costs through rates and charges



The Traditional Ratemaking Process



Cost Allocation

- A class cost of service study is a study in which the total company cost of service (revenue requirement) is spread or allocated to customer classes.
- The allocation of the total company cost of service to the individual customer classes can provide a revenue requirement target for each customer class, so that each class of customers pays the costs that the utility incurs to serve that class.

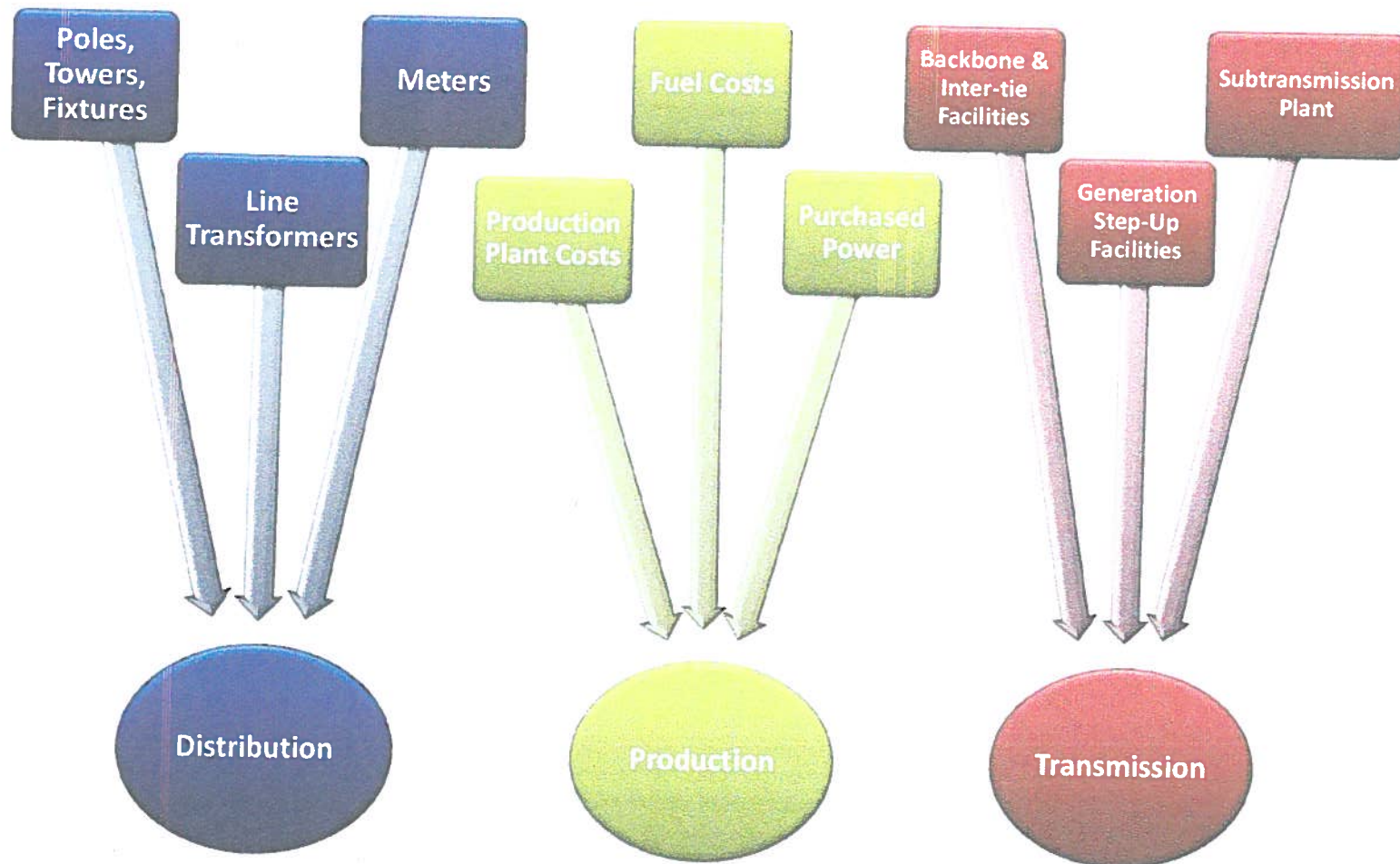


Cost of Service Study Steps

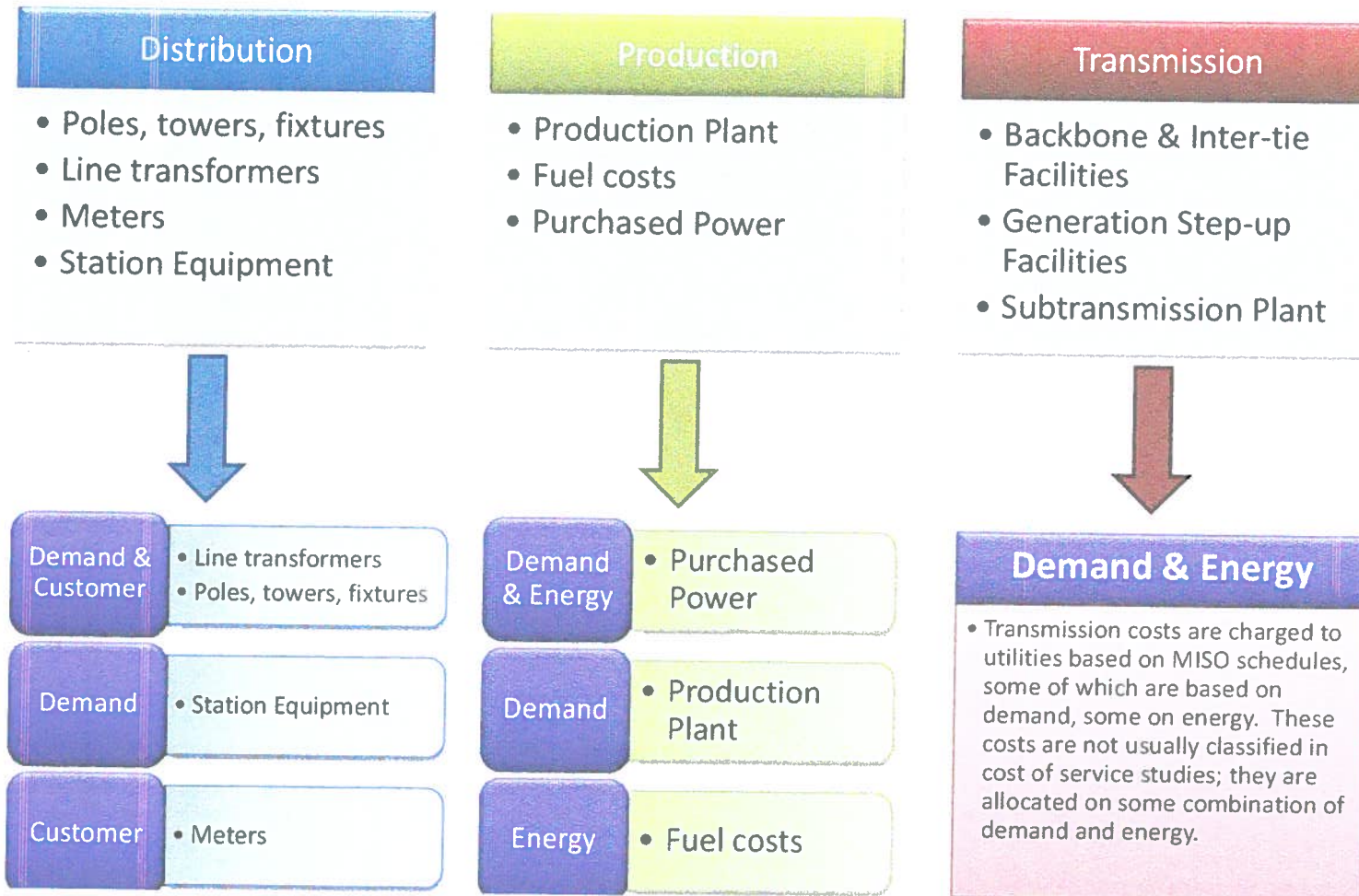
- Functionalization: costs broken down into production, transmission, distribution
- Classification: costs classified by customer, energy, demand
- Allocation: costs allocated to different customer classes – residential, commercial, industrial



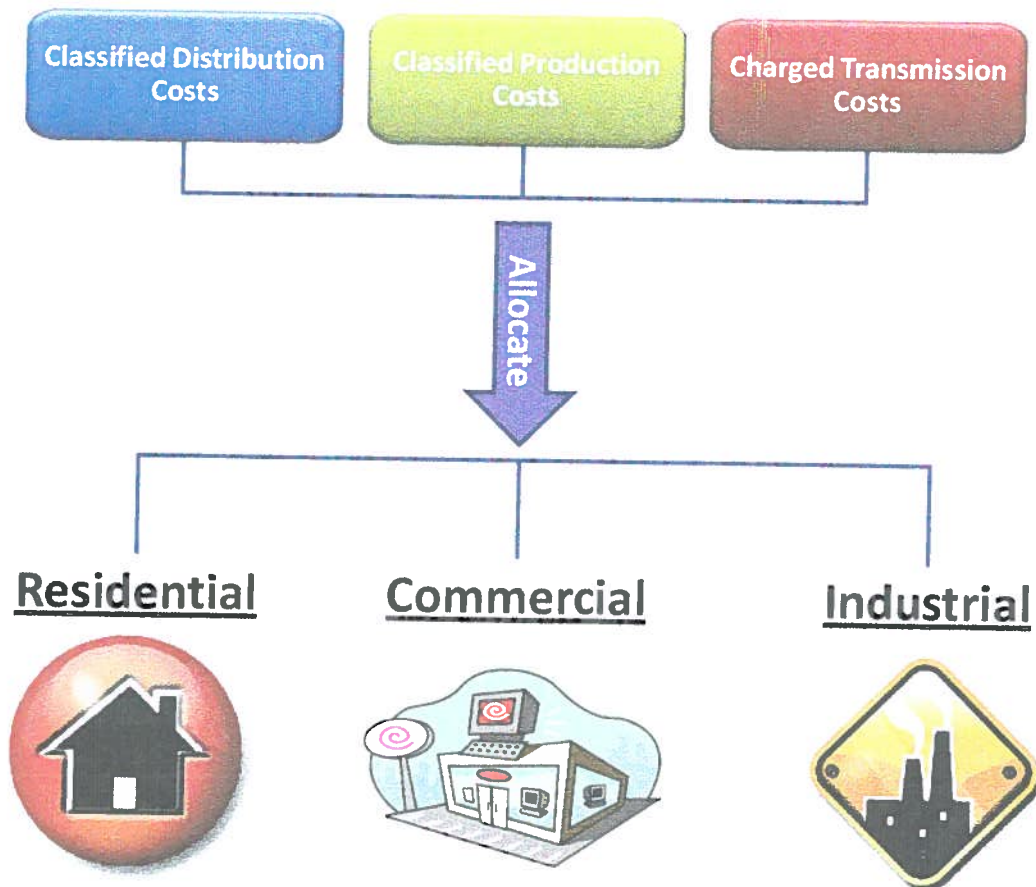
Cost Functionalization



Functionalization to Classification



Classification to Allocation



Production Cost Allocation

- Can be based on demand, energy use, or a combination of both
- Examples:
 - 100/0 – 100% demand, 0% energy use
 - 75/25 – 75% demand, 25% energy use
 - 50/25/25 – 50% demand, 25% on-peak energy use, 25% total energy use
- Demand typically measured at a peak or peaks –
 - 12 CP – system peak hour in each month of a year
 - 4 CP – system peak hour on 4 highest peak days of a year



Consumers Energy Case No. U-17087 Example

Total Revenue Requirement: \$4 Billion

Cost Allocation Across 3 Rate Classes



Residential

43.6%



Class Requirement:
\$1.8 Billion

Commercial

25.6%



Class Requirement:
\$1 Billion

Industrial

30.8%



Class Requirement:
\$1.2 Billion

Consumers Energy Cost of Service Study Summary

Case No. U-17087

(Thousands of dollars)

	<u>Total Retail</u>	<u>Total Residential</u>	<u>Total Commercial</u>	<u>Total Primary</u>
(A) Total Revenue (if current rates unchanged)	3,935,397	1,736,575	992,261	1,206,562
(B) Total Expenses	3,489,174	1,517,021	879,451	1,092,702
(C) Net Operating Income <i>Line A – Line B</i>	446,223	219,553	112,810	113,860
(D) Return	536,203	253,350	145,494	137,359
(E) Income Deficiency <i>Line D – Line C</i>	89,980	33,797	32,683	23,500
Revenue Deficiency				
(F) <i>Line E * Revenue Multiplier</i> (accounts for taxes)	147,270	55,315	53,493	38,462

(G) Revenue Requirement (Total Cost of Service) <i>Line A + Line F</i>	4,082,667	1,791,890	1,045,754	1,245,024
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PA 286 of 2008

- Sec. 11(1) requires MPSC to move to cost-of-service rates (“de-skewing”)
 - By Oct. 6, 2013 for DTE and Consumers (deadline met)
 - Electric rates for other companies moved toward cost of service
- Limits impact on residential customers to 2.5% annually
- Limits ability to approve special contracts or rates
- Why PA 297 of 2010 was necessary for E-1 rate

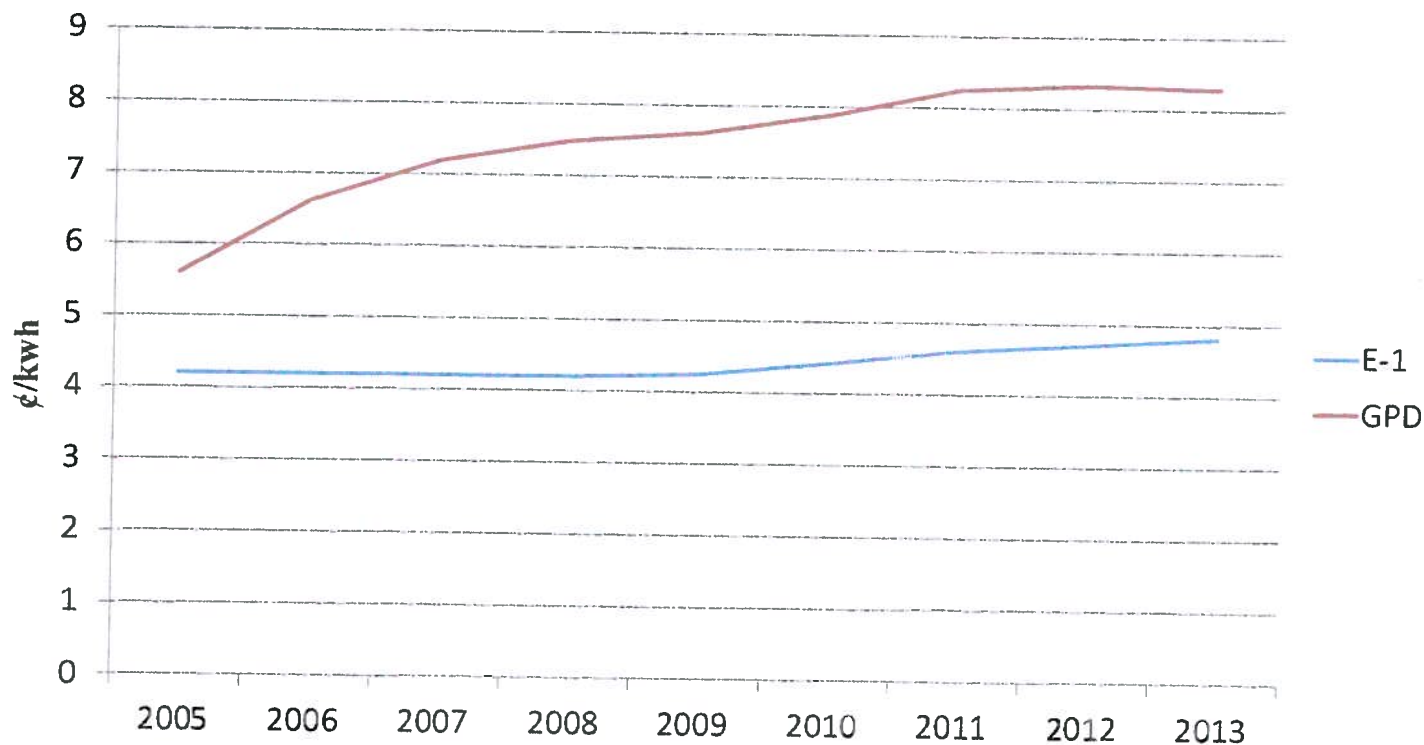


Consumers Energy E-1 Tariff

- Approved by the MPSC on November 22, 2005 for a ten year period in Case No. U-14692
- Available to annual new loads not served prior to Order date of at least 70,200,000 kWh on single premises – actual load of 2,037,000,000 kWh in 2012
- All inclusive rate of 4.2 cents per kWh – no changes due to rate cases, power supply cost recovery charge, etc.
- Escalation starting in 2009 of 50% change in annual variable energy costs with increases limited to 8% through 2011 and to 4% after 2011
 - currently 4.8 cents per kWh thru April 1, 2014
- Annual contract with CE required with minimum monthly loads of 5,850,000 kWh
- All Other Dow HSC load served on General Service Primary Demand **Rate GPD**



Consumers Energy Electricity Charges E-1 vs. GPD



HSC Contributions to CE Revenue

	HSC on GPD	HSC on E-1	Total HSC
Rate	7.8 cents/kWh	4.8 cents/kWh	5.5 cents/kWh
Revenue Requirement	\$57 million	\$170 million	\$227 million
Revenue Generated	\$57 million	\$106 million	\$163 million
Difference	\$0	\$64 million	\$64 million
Contribution to Fixed Costs	\$32 million	\$31 million	\$63 million

